

Monthly Report of Prospects for Japan's Economy

October 2019

Macro Economic Research Center
Economics Department



The Japan Research Institute, Limited

<http://www.jri.co.jp/english/periodical/>

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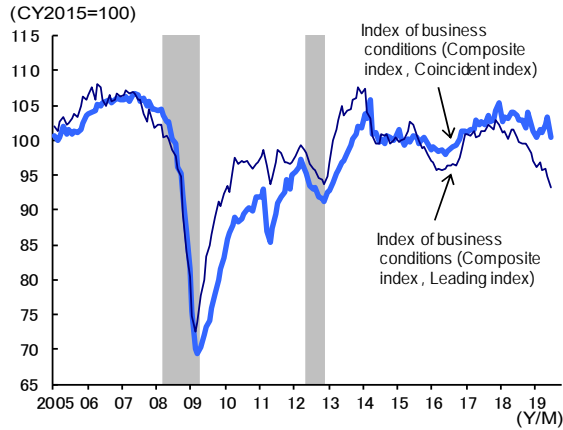
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The General Situation of Japan's Economy – A Sense of Standstill Is Felt in Economic Activity

Figure 1-1 Economic Activity

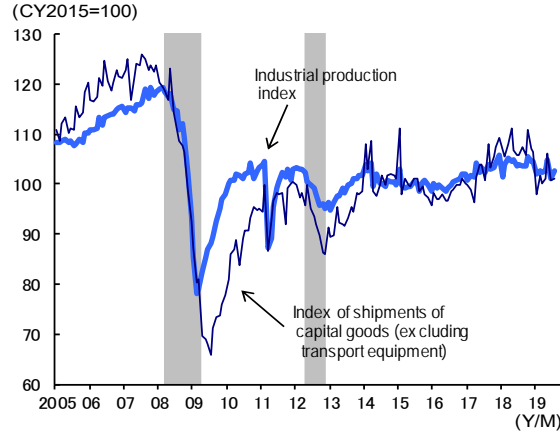
The CI coincident index remained virtually flat. The CI leading index remained on a declining trend.



Source: The Cabinet Office.

Figure 1-2 The Corporate Sector

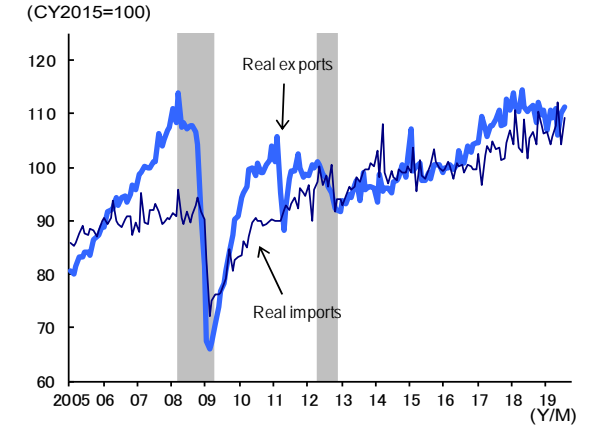
Industrial production continued to stagnate mainly for capital goods and producer goods.



Source: The Ministry of Economy, Trade and Industry.

Figure 1-3 Overseas Demand

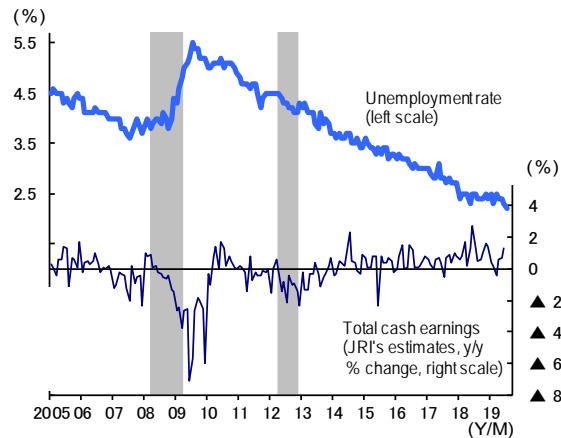
Decline in exports, mainly to Asia, bottomed out. Imports decreased, particularly of crude oil and petroleum products.



Source: The Bank of Japan.

Figure 1-4 Employment and Income

The unemployment rate is hovering around its lowest level since 1992. Nominal wages increased for the third consecutive month.

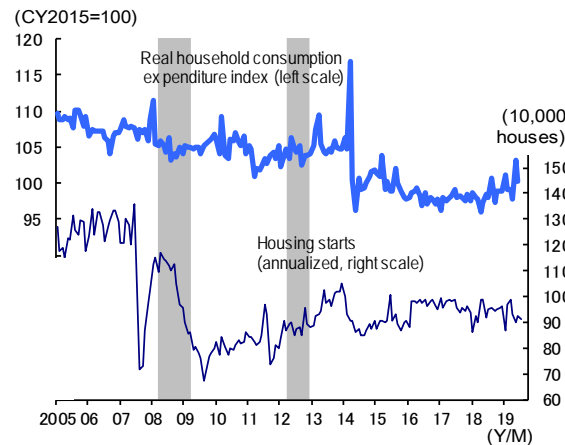


Source: The Ministry of Internal Affairs and Communications, The Ministry of Health, Labor and Welfare.

* The shaded area indicates the recession phase.

Figure 1-5 The Household Sector

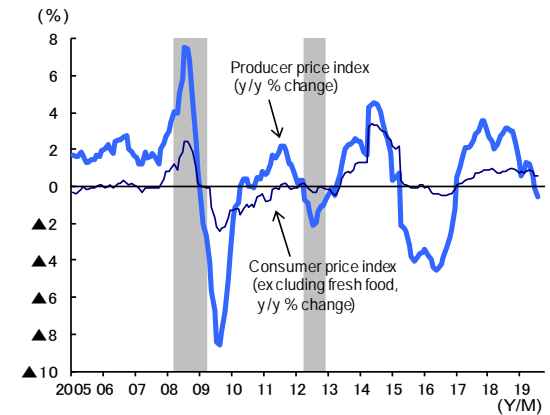
Real household consumption picked up, albeit with fluctuations. Housing starts were sluggish.



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office, The Ministry of Land, Infrastructure and Transport.

Figure 1-6 Prices

Producer prices declined mainly for raw materials. Consumer prices remained virtually flat.



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications, The Bank of Japan.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Domestic Demand Stays Firm, While Corporate Production Activities Remain Sluggish

◆ Positive Growth for the Third Consecutive Quarter Recorded in the April-June Period

Japan's real GDP in the April-June 2019 period increased by 1.3 percent on an annualized quarter-on-quarter basis (national accounts, second preliminary quarterly estimates of GDP), achieving positive growth for the third consecutive quarter. By demand category, while exports, mainly to Asia, remained sluggish, domestic demand including private consumption, business fixed investment and public investment continued to grow steadily.

◆ Industrial Production Has Seen Some Ups and Downs

The Industrial Production Index for July increased for the first time in two months, up 1.3 percent from the previous month. By industry, increased production was seen across a broad range of industries due to the response to a rush in demand prior to the scheduled consumption tax rate hike as well as a reaction to last month's significant decrease in production.

As for the outlook of production plans, however, some ups and downs are anticipated. Specifically, industrial production is forecast to continue to increase by 1.3 percent month-over-month in August, but it will likely decrease by 1.6 percent month-over-month in September.

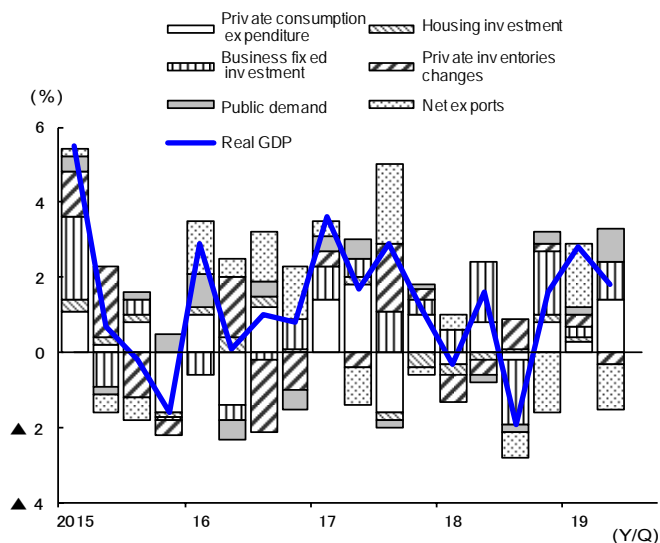
While the decline in exports, primarily to Asia, has bottomed out, full-fledged recovery is expected to take some time as persistently high inventories are weighing on production activities.

◆ The Household Sector Has Been Growing Steadily

In the household sector, a favorable employment situation has continued with the unemployment rate in July decreasing to 2.2 percent, which is the lowest level since October 1992.

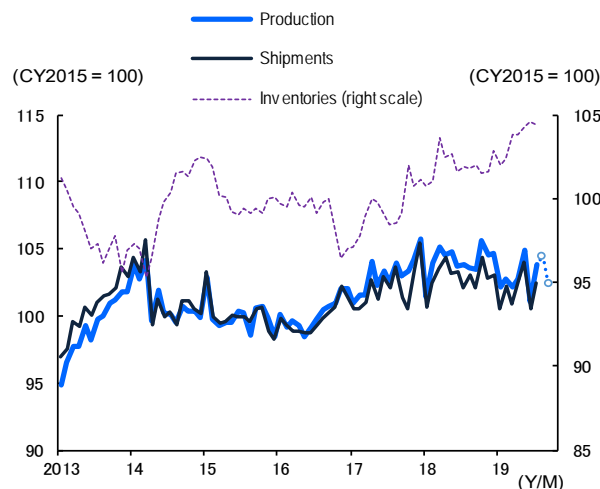
While private consumption has seen significant fluctuations due to the effects of the consecutive holidays in association with the change of era as well as weather factors, overall consumption has been growing moderately.

Figure 2-1 Real GDP Change Rate by Demand Item <the first preliminary estimates, on an annualized q/q change basis, seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

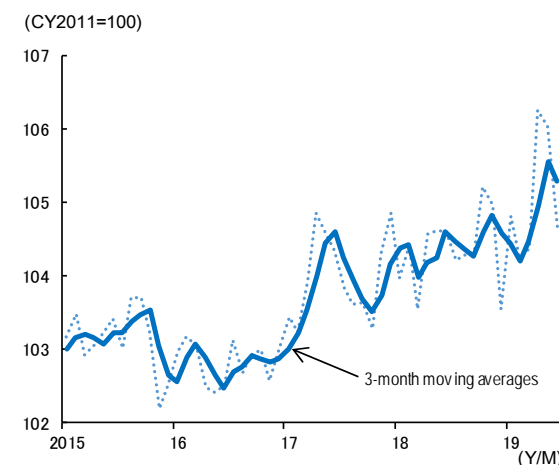
Figure 2-2 Industrial Production Index <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Note: The latest two figures in the industrial production index are forecasts for August and September based on the production forecast index.

Figure 2-3 Synthetic Consumption Index <seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Exports Are Expected to Pick up

◆ Exports of Goods Are Expected to Pick up

The declining trend for goods exports came to a halt. Looking at exports by category, while exports of capital goods, mainly to Asia including China, continued to stagnate, exports of electronic parts and devices increased as sales of smartphones had bottomed out.

As for future prospects, since the Chinese economy is expected to pick up thanks to the government's economic stimulus measures, Japan's exports of capital goods to Asia are anticipated to return to growth in the future.

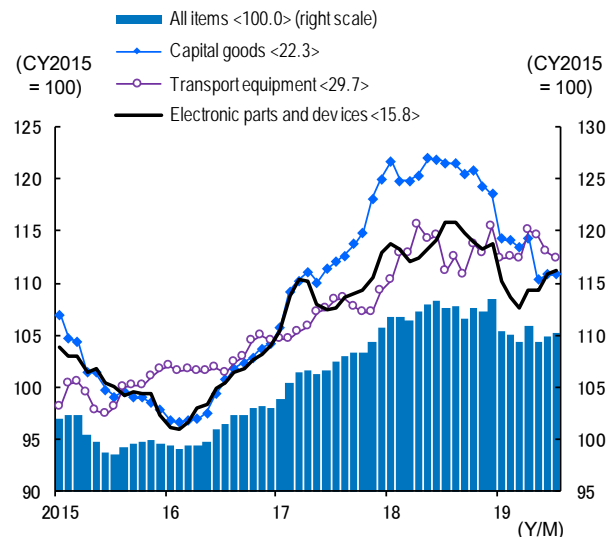
Having said that, amid the lack of momentum for the global economy on the whole, a strong recovery of overall exports will be difficult to achieve.

◆ Demand Related to Inbound Tourism Has Been Sluggish

The number of tourists that visited Japan in July declined by 2.8 percent over the previous month. The number of Korean tourists visiting Japan decreased against the backdrop of the deterioration in the relationship between Japan and Korea in line with the tightening of export controls.

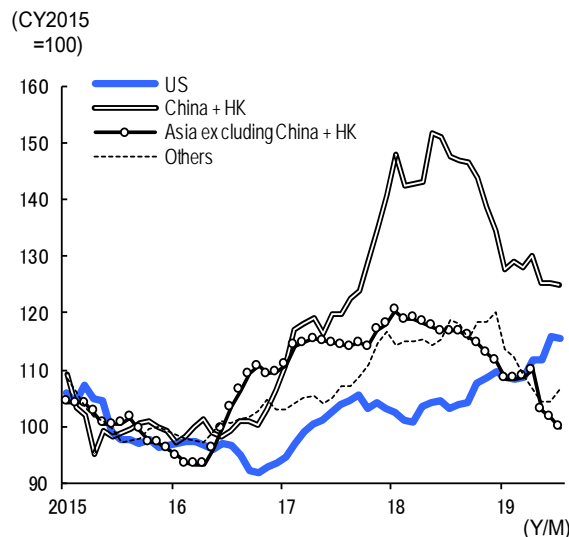
It has been reported in media that the number of new bookings for travel to Japan made by Korean travel agencies has been reduced by half on a year-on-year basis since the beginning of August. It is likely that the number of Korean tourists visiting Japan will further decrease in the future. While an increase in the number of tourists from other Asian countries including China will help avoid a significant decline in demand related to inbound tourism, the growth of demand is expected to be sluggish for the time being.

Figure 3-1 Real Exports by Item
<seasonally adjusted,
3-month moving averages>



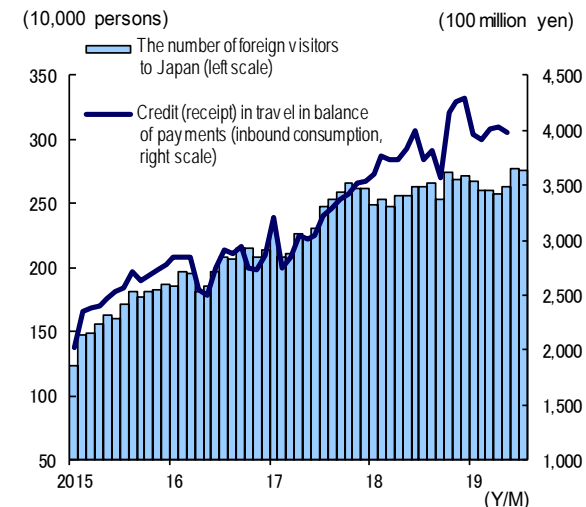
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.
Note: Figures in the angled brackets show the shares in total nominal exports in CY2018.

Figure 3-2 Real Exports of Capital Goods by Destination
<seasonally adjusted,
3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, The Bank of Japan.

Figure 3-3 Receipt in Travel in Balance of Payments
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Finance, Japan National Tourism Organization (JNTO).

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Business Fixed Investment Has Been on the Rise As Corporate Profits Remain at a High Level

◆ Corporate Profits Remain at a High Level

Corporate earnings have seen some fluctuations, while remaining at a high level. According to the Financial Statements Statistics of Corporations by Industry quarterly report, current profits for the period from April-June 2019 declined for the first time in two quarters, down 5.0 percent from the previous quarter. Since the decline was attributable to a reaction to the large dividend income of specific companies (pure holding companies) in the previous quarter, the overall trend has remained virtually flat.

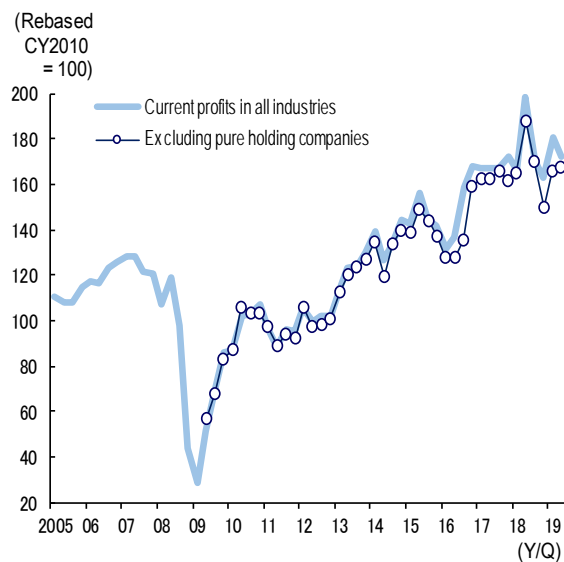
As for the outlook for corporate earnings, while the current appreciation of the yen will exert downward pressure, overall corporate earnings are anticipated to remain at a high level backed by firm domestic demand.

◆ Business Fixed Investment Will Remain on a Rising Trend

Capital investment has remained on an increasing path. Looking at business fixed investment for the April-June 2019 period by industry, while investment in manufacturing industry declined due to adverse external conditions including the trade conflict between the United States and China and the slowdown in China's economy, investment in non-manufacturing industry surged mainly for software investment aimed at labor saving and digitalization.

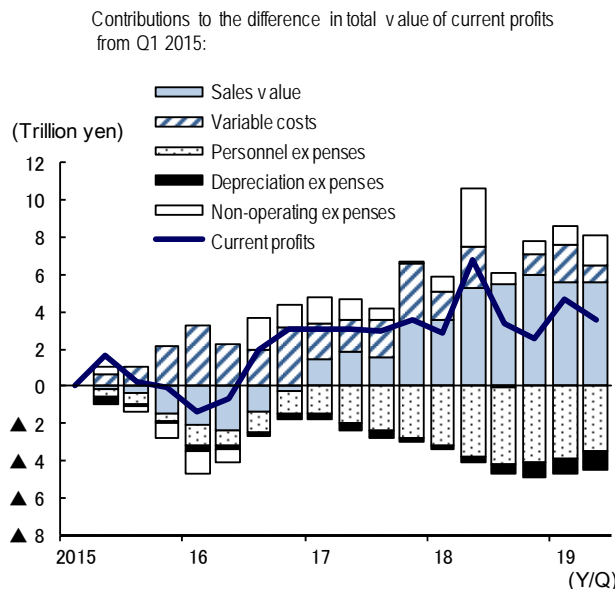
As for the future outlook, a favorable earnings environment is expected to support the appetite for investments by the corporate sector. Capital expenditure is forecast to remain on a rising trend as demand for investments for rationalization and labor saving as well as maintenance and replacement continues to grow firmly.

Figure 4-1 Current Profits of Japanese Corporations
<seasonally adjusted>



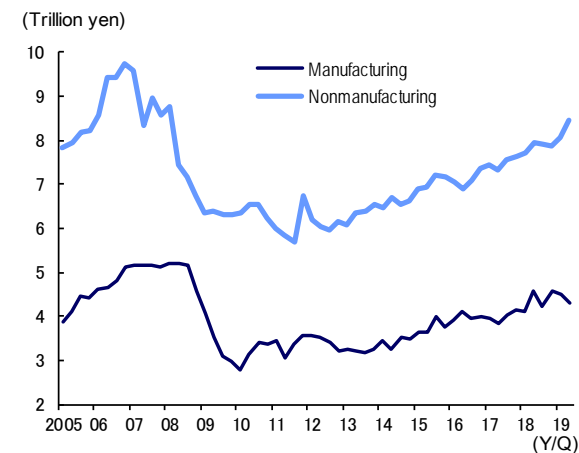
Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.
Note: All industries except for financial services and insurance.

Figure 4-2 Contributions of Factors to Change in Total Value of Current Profits



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Figure 4-3 Value of Business Fixed Investment Based on Financial Statements Statistics of Corporations by Industry
<seasonally adjusted>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: Including software investment.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Income Is Recovering Steadily

◆ The Income Situation Has Continued to Improve

While the pace of growth in the number of workers has declined compared with the previous year, the rising trend has continued with the number of workers increasing by around 800,000 year-on-year. Currently, the number of work hours per employee has been decreasing due to the effect of the workstyle reform among other factors, which has also contributed to boosting the number of workers. As for the number of workers by company size, significant growth has been seen for large-scale enterprises for which the upper limit of overtime work has been applied since April 2019.

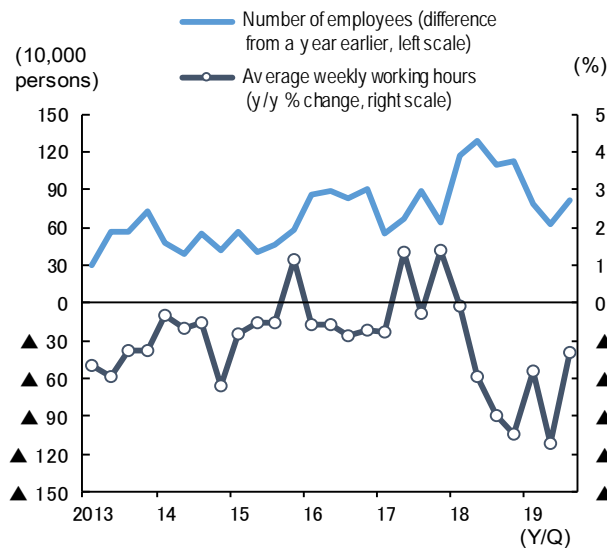
Meanwhile, on the wages front, nominal wages have remained on a rising trend. Looking at scheduled salaries for full-time workers, growth at around 1 percent on a

year-on-year basis has been maintained since the beginning of 2019 when excluding the effects of sample switchover.

◆ Real Income Is Likely to Increase Firmly

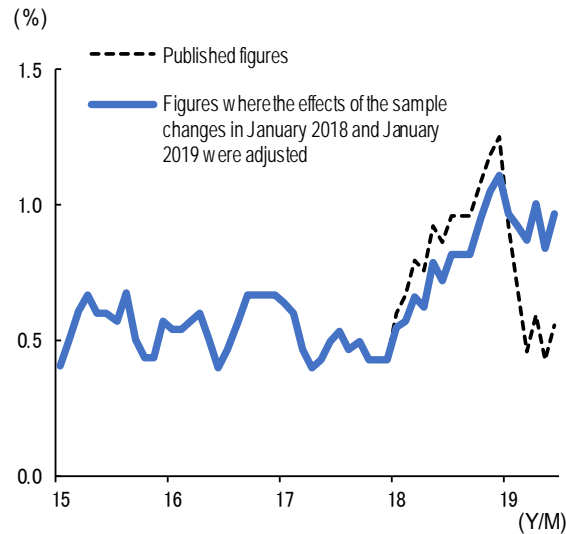
A look at future prospects shows a high likelihood that moderate growth in the number of employees will continue as a strong sense of labor shortages has still been felt by many industries. Nominal wages will likely remain on a steady rise given the tight labor supply/demand conditions. On the other hand, on the price front, it is expected that the provision of free education and nursery care and the introduction of the reduced tax rate will help minimize price increases as a result of the hike in the consumption tax. As a result, growth at around the mid-1 percent level will likely be maintained in real compensation for employees.

Figure 5-1 Number of Employees and Average Weekly Working Hours



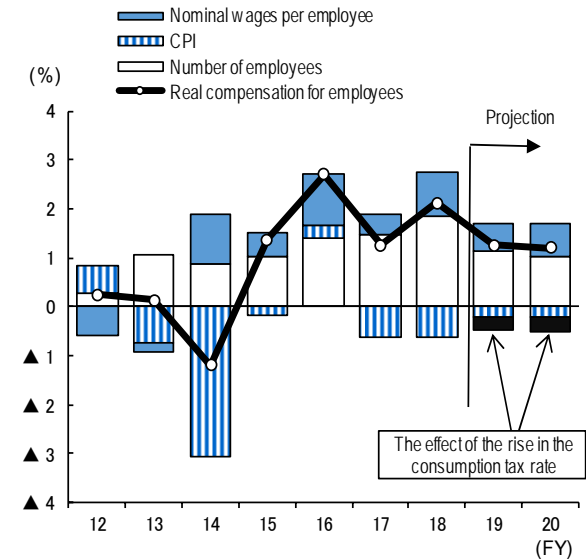
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Internal Affairs and Communications.
Note: The figures in Q3 2019 are for July 2019.

Figure 5-2 Scheduled Salaries for Full-time Workers <year-on-year % change, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Health, Labor and Welfare.

Figure 5-3 Real Compensation for Employees <year-on-year % change>



Source: The Japan Research Institute, Ltd. based on data of The Cabinet Office.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Private Consumption Expenditure Is Increasing Moderately

◆ Retail Sales in July Saw a Downswing Due to the Effects of Unfavorable Weather

Retail sales in July saw a significant downswing for household appliances including air conditioners and electric fans as well as seasonable merchandise such as summer clothes and fruits and vegetables as temperatures remained low due to the extended rainy season. However, since sales of automobiles, pharmaceuticals and cosmetic products, which are hardly affected by weather, have remained firm, we judge that the downturn in private consumption is temporary.

As for future prospects, a moderate recovery is anticipated to continue, underpinned by favorable employment and income conditions. The negative effects of the hike in consumption tax will likely be mitigated significantly thanks to the measures to reduce tax burdens. In addition, future consumption of durable goods will also be supported by the fact that products purchased by users of the eco point system for household appliances 10 years ago are approaching the time for

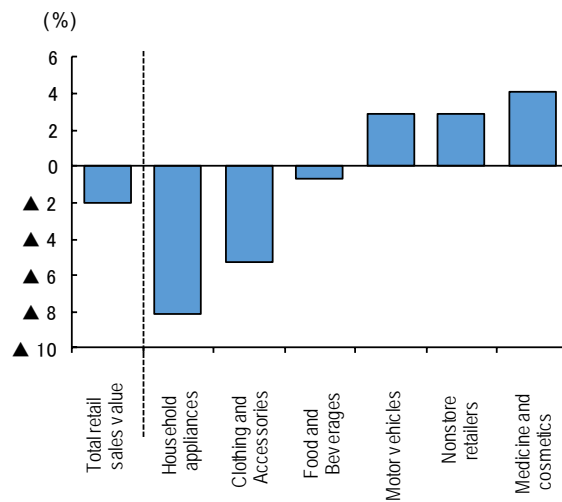
replacement.

◆ Housing Investment Has Turned to a Declining Trend

The number of housing starts in July decreased for the first time in two months, down 1.3 percent month-over-month. The number of housing starts for owner-occupied housing saw a significant plunge by 6.6 percent month-over-month, reflecting a reactionary decline in line with the rush in demand prior to the consumption tax rate hike.

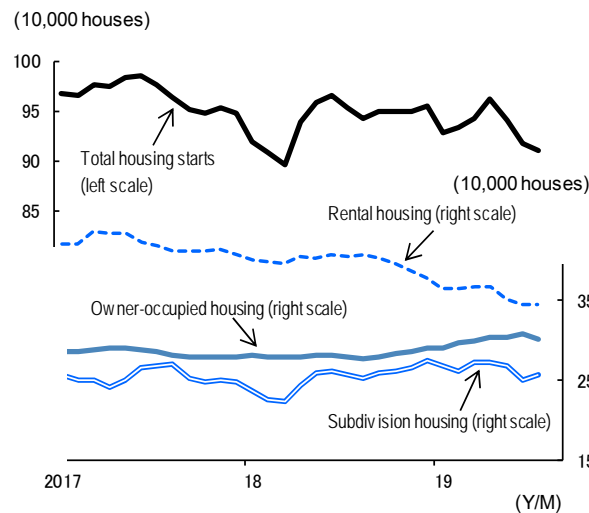
As for the future outlook, the number of housing starts for owner-occupied and subdivision housing, which had been benefited from the rush in demand, will likely remain on a diminishing trend in the future. Having said that, as the government will implement measures for levelling demand in line with the tax rate hike, the rise in rush demand will be limited compared to that for the previous tax rate hike. Given this situation, a significant decline in the number of housing starts after the tax rate hike will likely be avoided.

Figure 6-1 Retail Sales Value by Item In July 2019 <year-on-year % change>



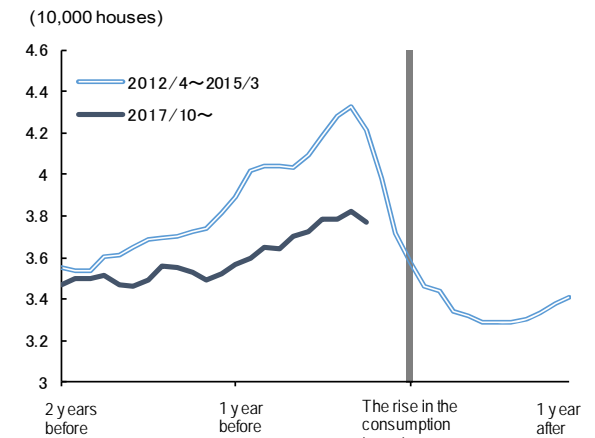
Source: The Japan Research Institute, Ltd. based on data of The Ministry of Economy, Trade and Industry.

Figure 6-2 Housing Starts by Type <annualized, seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport.

Figure 6-3 Housing Starts for Owner-occupied and Subdivision Detached Houses <seasonally adjusted, 3-month moving averages>



Source: The Japan Research Institute, Ltd. based on data of The Ministry of Land, Infrastructure and Transport.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Topic: Software Investment Is Anticipated to Expand

◆ Software Investment Has Been Firm

Software investment by large-scale enterprises has been expanding since the beginning of 2018.

This is due to the situation that large-scale enterprises with rich management resources such as personnel, capital and data have been making full-fledged investments in advanced digital technologies including artificial intelligence (AI) and robotic process automation (RPA) whose practical utilization has been on the rise. In fact, the markets for these technologies have been rapidly expanding.

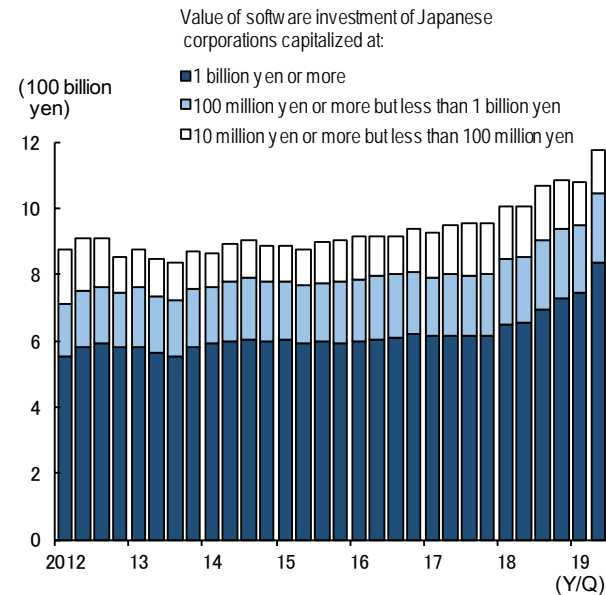
◆ Investment Expansion Is Also Anticipated to Continue into the Future

As for future prospects, software investment is forecast to continue to increase

from a medium- to long-term perspective. According to an investigation by MM Research Institute, the level of satisfaction among the companies which have introduced RPA is relatively high, and approximately 80 percent of such companies have a policy to further expand business operations that utilize RPA. In addition, since Japanese companies have been behind those in other advanced nations in terms of the introduction of AI, they are expected to further accelerate investments in advanced digital technologies in the future. Indeed, the corporate sector's software investment plan for fiscal 2019 has been even more bullish than previous years.

On the other hand, in order to respond to robust demand for software investment, challenges will remain including the development and securing of scarce IT talents.

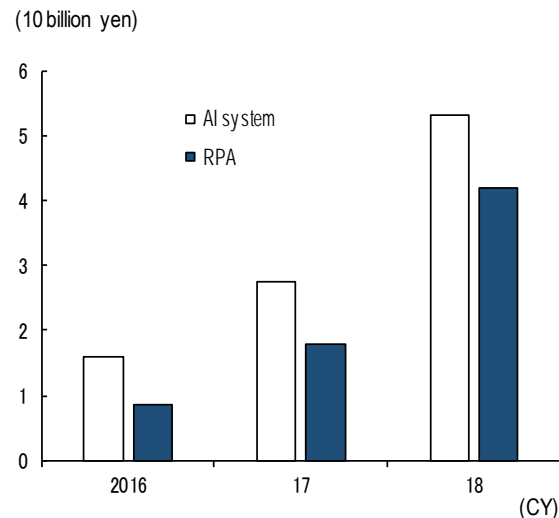
Figure 7-1 Value of Software Investment of Japanese Corporations by Capital <4-quarter moving averages>



Source: The Japan Research Institute, Ltd. based on the data of The Ministry of Finance.

Note: All industries except for financial services and insurance.

Figure 7-2 AI System and RPA Markets in Japan

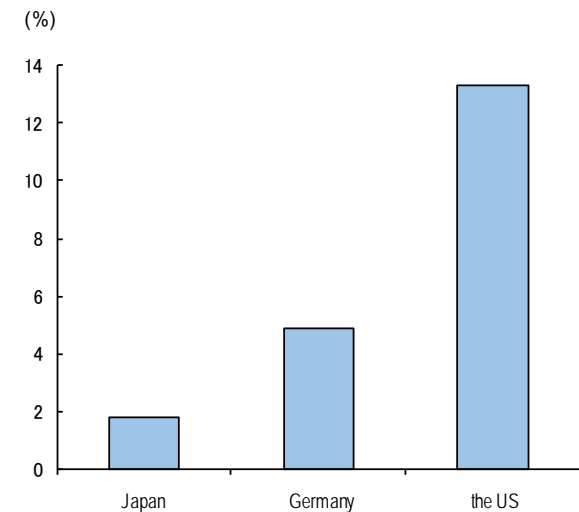


Source: The Japan Research Institute, Ltd. based on the data of IDC Japan, Yano Research Institute, Ltd.

Note: 1. The research for the AI system market here is targeted for natural language processing.

2. The figures of the RPA market are on a fiscal year basis, and that in FY2018 is an estimate.

Figure 7-3 Ratio of Companies which Introduced AI by Country



Source: The Japan Research Institute, Ltd. based on the data of MM Research Institute, Ltd.

Monthly Report of Prospects for Japan's Economy October 2019
The Japan Research Institute, Limited

Prospects for Japan's Economy - Projected Real GDP Change; 0.8% in FY2019 and 0.7% in FY2020

◆ Mild Recovery of the Japanese Economy Will Likely Continue, Driven by Domestic Demand

(1) According to the Second Preliminary Quarterly Estimates of GDP (2nd QE), Japan's real GDP growth for the April-June 2019 period was revised to +1.3% on an annualized quarter-on-quarter change basis (or +0.3% from the preceding quarter), which was lower than the First Preliminary Quarterly Estimates of GDP (1st QE) (+1.8% on an annualized quarter-on-quarter change basis and +0.4% from the preceding quarter) due primarily to the downward revision of capital investment. However, growth exceeding the potential growth rate estimated at around 1% will likely be secured even after the revision. The 2nd QE indicated that there is no significant change in the current recognition that Japan's economy has been on the recovery trend.

(2) As for future prospects, while a sense of economic slowdown may increase over the short term due to the effects of the reaction to higher growth and the consumption tax rate hike, Japan's economy is anticipated to continue to grow moderately, driven by domestic demand.

(3) Exports are expected to pick up slightly against the backdrop of the bottoming out of global IT demand and the stabilization of the Chinese economy thanks to the government's economic stimulus measures. Amid the lack of momentum of the global economy on the whole, however, there is little hope for a robust recovery.

(4) Sluggish exports will likely weigh on investment appetite in the corporate sector, mainly for the manufacturing industry. Capital expenditure, however, is forecast to remain on a rising trend, reflecting resilient demand for investments backed by structural factors, including investments aimed at labor-saving against the backdrop of labor shortages and workstyle reforms, as well as the need for updating dilapidated equipment and R&D investment for the utilization of new technologies.

(5) Personal consumption is also anticipated to continue to grow moderately, underpinned by the improvement in the income environment. While the decline in purchasing power as a result of the consumption tax rate hike will put downward pressure on personal consumption, measures to minimize the impact of the consumption tax rate hike, such as the introduction of a reduced tax rate and the provision of free education and nursery care, are expected to significantly reduce the burden on households. Therefore, we believe that a substantial decline in consumer spending is likely to be avoided given the expectation that a reactionary decrease in response to the rush demand will be minimal.

(6) Consequently, Japan's economy is forecast to continue to grow steadily even under the impact of the consumption tax rate hike, with the growth rate expected to be +0.8% for FY2019 and +0.7% for FY2020. However, attention must be paid to the risk that deterioration in the external environment could weigh down Japan's economy, considering the increasing uncertainty in the outlook of overseas economies, including conflicts between the United States and China and Brexit.

◆ The Year-on-year Change Rate in the Core CPI Will Likely Continue to Be Slightly below 1 Percent

(7) The year-on-year change rate in the core CPI, which excludes fresh food, remained virtually flat in July, mainly because the pace of rise in energy prices slowed down, despite the rise in the price of smartphones. Looking ahead, it is predicted that the year-on-year increase rate in the core CPI will continue to be slightly less than 1 percent. This is because, while the upward pressure will likely strengthen from the supply-demand perspective, the pace of rise in energy prices will likely slow down further.

Figure 9 Projections for GDP Growth and Main Indicators of Japan (as of September 9, 2019)

	(seasonally adjusted, annualised % changes from the previous quarter)									(% changes from the previous fiscal year)		
	CY2019				CY2020				CY2021	FY2018	FY2019	FY2020
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	(Actual)	(Projection)	(Projection)
	(Actual)	(Actual)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Projection)	(Actual)	(Projection)	(Projection)
Real GDP	2.2	1.3	0.7	▲ 2.0	1.3	1.3	1.0	0.7	1.2	0.7	0.8	0.7
Private Consumption Expenditure	▲ 0.0	2.5	1.0	▲ 4.0	2.2	2.0	▲ 0.4	1.4	1.0	0.4	0.6	0.6
Housing Investment	3.1	0.3	0.0	▲ 5.8	▲ 3.1	0.0	1.0	2.5	0.8	▲ 4.3	0.6	▲ 0.8
Business Fixed Investment	▲ 1.0	0.8	2.6	▲ 0.5	1.9	1.6	1.8	1.8	2.0	3.5	1.3	1.6
Private Inventories (percentage points contribution)	(0.3)	(▲ 0.2)	(▲ 0.2)	(0.1)	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)	(0.1)	(0.1)	(0.0)
Government Consumption Expenditure	▲ 0.4	4.9	0.4	0.0	0.4	1.0	2.5	▲ 0.5	1.0	0.9	1.7	0.8
Public Investment	6.1	7.2	0.5	0.0	▲ 2.5	▲ 0.6	0.7	1.6	1.3	▲ 4.0	1.9	▲ 0.1
Net Exports (percentage points contribution)	(1.7)	(▲ 1.2)	(▲ 0.1)	(0.5)	(▲ 0.1)	(▲ 0.2)	(0.3)	(▲ 0.4)	(0.1)	(▲ 0.1)	(▲ 0.2)	(0.0)
Exports of Goods and Services	▲ 7.6	▲ 0.1	1.3	1.7	1.4	1.4	2.6	▲ 1.2	2.0	1.5	▲ 0.9	1.4
Imports of Goods and Services	▲ 16.0	6.9	1.8	▲ 1.0	2.1	2.4	0.6	1.3	1.6	2.1	0.2	1.3
(Ref.) Domestic Private Demand (percentage points contribution)	(0.2)	(1.3)	(0.8)	(▲ 2.4)	(1.4)	(1.4)	(0.1)	(1.1)	(0.9)	(0.8)	(0.6)	(0.6)
(Ref.) Public Demand (percentage points contribution)	(0.2)	(1.3)	(0.1)	(0.0)	(▲ 0.0)	(0.2)	(0.5)	(▲ 0.0)	(0.3)	(▲ 0.0)	(0.4)	(0.2)

	(% changes from the same quarter of the previous year)									(% changes from the previous fiscal year)		
	1~3	4~6	7~9	10~12	1~3	4~6	7~9	10~12	1~3	FY2018	FY2019	FY2020
Nominal GDP	1.1	1.3	2.0	1.7	1.1	1.3	1.1	1.3	1.2	0.5	1.5	1.2
GDP deflator	0.1	0.4	0.5	1.1	0.9	0.8	0.8	0.3	0.2	▲ 0.2	0.7	0.5
Consumer Price Index (excluding fresh food)	0.8	0.8	0.5	0.9	1.0	0.9	1.1	0.8	0.8	0.8	0.8	0.9
(excluding fresh food, consumption tax, education free of charge)	0.8	0.8	0.5	0.6	0.6	0.6	0.8	0.8	0.9	0.8	0.6	0.8
Unemployment Rate (%)	2.5	2.4	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.4	2.3	2.2
Exchange Rates (JY/US\$)	110	110	107	106	106	106	106	106	106	111	107	106
Import Price of Crude Oil (US\$/barrel)	63	72	65	65	66	67	68	68	68	72	67	68

Source: The Cabinet Office; The Ministry of Internal Affairs and Communications; The Ministry of Economy, Trade and Industry; The Ministry of Finance.

The projection figures are based on those of The Japan Research Institute, Ltd.

Note : "▲" indicates minus.